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NO. 16834

United States
COURT OF APPEALS
for the Ninth Circuit

RUSHLIGHT AUTOMATIC SPRINKLER CO.,
Appellant,

vs.

UNITED STATES OF AMERICA,
Appellee.

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Appellant,

vs.

RUSHLIGHT AUTOMATIC SPRINKLER CO.,
Appellee.

APPELLANT'S and CROSS-APPELLEE'S REPLY BRIEF

Appeals from the United States District Court for the District of Oregon.

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THE ERRONEOUSLY ALLOWED TAX CREDIT WAS NOT A REFUND WITHIN THE MEANING OF SECTION 3746

On page 9 of its brief the government concedes that "if this were an action to collect a statutory deficiency in tax it would be necessary to first issue a deficiency

notice, and we concede that such notice has not been issued here."

To clarify the issues we will make a like concession: If the erroneous credit in question constituted a refund of taxes to appellant within the meaning of Section 3746 of the Internal Revenue Code of 1939, then the government is entitled to prevail.

Most of the government's argument is based on its premise that the erroneous tax credit was such a refund. If this premise is not correct then its argument completely fails.

The crucial point is that at which the government seeks to attach the label "refund to the appellant" to the erroneous credit in question.

On page 8 of its brief the government starts out mildly by saying that the tax credit "is in the nature of a tax refund." It initially cites for this proposition *United States v. Failla,* 3 Cir., 219 F2d 212, a renegotiation collection suit. However, an analysis of that case shows that the court there recognized that the tax credit was a tentative matter and any errors therein were to be corrected under the refund and deficiency procedure under the Internal Revenue Code. In that case the contractors were claiming that they had not been allowed a sufficient tax credit and the court held that the amount of the tax credit had to be determined under the administration procedures set forth in the Internal Revenue Code, i.e., a refund claim must be filed. This conclusion was based upon Judge Hand's opinion in *Stow Mfg. Co. v. Commissioner*, 2 Cir., 190 F2d 723, which

case was one involving the converse situation, i.e., too much tax credit was given which was held to have created a deficiency in tax. (See appellant's opening brief, page 5.)

Certainly this case does not support the proposition that the erroneous tax credit given the Rushlight-Macri joint venture was a refund to appellant. Nor do the other cases cited by the government on page 9 of its brief. In *Universal Oil Products Co. v. Campbell,* 181 F2d 451, the court used the government's magic word "refund" but such use was coupled with the statement that such credit *"must be considered in determining the amount of any deficiency"* in the taxpayer's taxes. The other two district cases cited by the government merely repeat what the court said in the *Universal Oil* case.

As to the four cases cited on page 11 of the government's brief, although the government says that they are cases where there was "money erroneously credited to the taxpayer," in each case the amount in question was *refunded to the taxpayer by government check.*

Nor does the case (*Merlin v. Sanders,* 243 F2d 821) which the government says dramatically points up its position change the situation. In fact that case, if carefully read and understood, dramatically points up our position. The facts in the *Merlin* case are complicated, but there were two different proceedings involved, the significance of which has completely escaped the government:

(1) Proceedings No. 1 was the suit to enjoin an attempted assessment on the part of the Director

without giving a deficiency notice. The taxpayer had taken an erroneous credit on her 1949 return in the sum of $487.08, an amount which had been refunded to her after she had filed her 1948 return.

(2) Proceeding No. 2, the one mentioned by the government in its brief, was one brought by the United States to intervene in the injunction suit and collect the amount of $487.08 which was included in a second refund check sent to the taxpayer on April 18, 1950.

As to Proceeding No. 1, the lower court entered a preliminary injunction and then later "granted the taxpayer's injunction on the ground that no statutory notice of deficiency had been sent by the Director but held that the United States was entitled to recover the amount erroneously refunded to taxpayer on April 18, 1950, plus interest."

There was no appeal from the judgment granting the injunction, and therefore the lower court's holding stands as authority for the proposition that even though there was an erroneous credit the provisions as to giving the statutory notice are still mandatory.

Furthermore, a correct understanding of the case destroys the logic of the government's attempt to distinguish *Maxwell v. Campbell,* 205 F2d 461 (ff 1, p 13).

In *Maxwell v. Campbell* the proceeding in question arose because "erroneous credits were revised." This was held to create a deficiency which required the statutory notice.

Furthermore, there is no difference between an action and an assessment, as the government suggests. *United States v. Price,* 9 Cir., 263 F2d 382, was a case where an action was brought. Although the case was reversed on another ground (361 US 304) the fact that an action cannot be brought to collect a deficiency was not questioned.

The government does not even attempt to distinguish the erroneous credit case from this circuit, *Jameson v. Repetti,* 239 F2d 901.

The government's argument on page 15 of its brief as to the statute running has no validity here since it is based on the government's statement that the statutory period for assessment ran three years after the return for the fiscal year ending October 31, 1953 was filed on April 14, 1954. This completely overlooks the exception to Section 275 (a) i.e., Section 276, the pertinent provisions of which are:

> "(d) * * * In the case of a deficiency attributable to the application * * * of a net operating loss carry-back * * * such deficiency may be assessed—
>
> "(1) In case a return was required * * * for the taxable year of the net operating loss * * * resulting in the carry-back, at any time before the expiration of the period within which (under Section 275 * * *) a deficiency * * * for such taxable year * * * may be assessed."

The record does not show when Rushlight's fiscal 1955 return was filed, but under this exception the time for assessment did not even start until the filing of that return.

Although the government seeks to disregard the joint venture, the fact remains that (a) the renegotiation agreement was between the government and the joint venture (Ex. 8); (b) it was the joint venture's profits that were eliminated by agreement (Ex. 8); (c) the demand for payment was made to the joint venture and the credit granted the joint venture was the combined tax credit for all the venturers (Ex. 5); (d) the payment of the net amount due was made by the joint venture's check (Ex. 1(c)).

We submit that the problems which arise because a joint venture or partnership is treated as the contractor under the Renegotiation Act shows the wisdom of the statutory scheme of treating the correction of errors in tax credits under the Internal Revenue Code's procedures for the collection of deficiencies. (See discussion in *Morris Kurtzon,* 17 TC 1542, factually on all fours with the case at bar.)

Respectfully submitted,

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